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November 4, 2004

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Jeffrey Carlisle
Chief, Wireline Competition Bureau
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

**Re: Puerto Rico Telephone Company
Request for Insular Universal Service Mechanism
CC Docket No. 96-45**

Dear Mr. Carlisle:

Thank you again for meeting with us last month concerning the state of local telephone service in Puerto Rico and the challenges of serving this high cost, but low income area of our country. This letter responds to your request for additional information regarding the difficulties in providing local telephone service in Puerto Rico as well as how a restoration of high cost universal funding, such as through an insular mechanism, would enable Puerto Rico Telephone Company ("PRT") to expand subscribership and maintain affordable rates despite those challenges.

Puerto Rico Presents a Compelling Case for High Cost Universal Service Funding

As we explained in our meeting, Puerto Rico is an area seriously deserving of high cost universal service funding. The penetration rate for telephone service within the commonwealth currently stands below 70 percent – far below both the national average (94 percent) and even the lowest state penetration rate (88.8 percent in Arkansas). The penetration rate in many of Puerto Rico's rural counties is substantially lower – in some places below 50 percent. Indeed, the mountainous, densely vegetated interior of the island contains numerous communities that are not yet passed by telephone plant or other basic utilities.¹ Attachment A is a map that shows the telephone penetration rates in counties throughout Puerto Rico.

The drastic situation in Puerto Rico stems directly from the higher costs of providing service associated with the terrain, the insular nature of the island, and the

¹ Approximately 98 percent of all occupied dwelling units in Puerto Rico have access to electrical service. However, a number of remote areas lack this basic service.

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area's economic condition. The island's rugged terrain and the lack of good roads in some parts of the island significantly hamper build-out and increase maintenance costs. The costs of providing service on the island are also far greater than on the mainland due to high shipping costs, the corrosive nature of the environment, and unpredictable and sometimes violent weather conditions. The ability of telephone companies in Puerto Rico to raise rates to cover these higher costs is very limited due to the relatively high cost of living in Puerto Rico coupled with the very low average income of the citizens. Puerto Rico's per capita income of less than \$10,000 per year is far lower than any U.S. state and results in over half of the population living below the poverty line.

In recognition of these challenges, Puerto Rico had received as much as \$51.9 million in annual high cost universal service funding. However, as a result of the Commission's revision of its high cost fund methodology in 1999, Puerto Rico now receives \$0.² Despite the obvious cost challenges in Puerto Rico, the cost approximation model for non-rural companies adopted by the agency strangely treats Puerto Rico as having the same cost characteristics as suburban New Jersey. Obviously New Jersey is a much more developed and accessible area that lacks the many cost-pricing challenges facing Puerto Rico.

Restoring High Cost Funding to Puerto Rico Is Essential to Maintaining and Expanding Affordable Telephone Service in Puerto Rico

Restoration of high cost universal service funding to Puerto Rico, such as through an insular mechanism, is essential for companies like PRT to be able to maintain affordable rates and to expand telephone service to new subscribers. From the high-cost program's inception until 1996, PRT was able to increase penetration rates on the island dramatically from as low as 25 percent in the 1970s to just over 70 percent. Over the years there has been a definite correlation between the availability of high cost universal service funding, PRT's capital investments, and an increase in telephone penetration in the commonwealth. Since funding began to be phased-down in 2001, the previously growing penetration rate has stagnated and fallen back slightly and capital investments have been reduced. *See Attachment B.*

² *See Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432 (1999) (Ninth Report and Order)*

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Similar to other companies that currently receive high cost loop support, PRT would use universal service funds for a variety of purposes in order to provide quality, modern, and affordable local telephone service to consumers. These uses include:

- Construction of new network and loop infrastructure to unserved areas and modernization of existing facilities;
- Maintenance of network for voice telephony and to ensure compatibility with broadband services;
- Maintenance of and improvements to quality of service;
- Maintenance of affordable rates; and
- Education and solicitation of potential first-time telephone customers.

Each of these is discussed in more detail below:

Construction of New Plant and System Modernization. Currently, PRT estimates that there are over 200 isolated communities in Puerto Rico without phone service. Many of these are in the interior of the island where the mountainous, jungle terrain and lack of good roads make the construction of new plant both very expensive and challenging. Indeed, a single loop in Puerto Rico can cost up to \$15,000. In addition, investment is needed to upgrade the telephone plant so that Puerto Ricans can enjoy telephone service of the same reliability and quality enjoyed by other Americans. Universal service funding is crucial to enabling PRT to make the investments needed to fund such network expansion and modernization, particularly in rural areas of the island. If high cost loop support is provided under the insular proposal to eligible carriers in Puerto Rico, PRT expects to commit at least 65 percent of such funds to expansion of service to low income and unserved areas, with the remainder used for maintenance and improvement of the network.

Network Maintenance. As noted above, the costs of maintaining a telephone network in Puerto Rico are very high due to the added expense of delivering equipment, tools and parts to the island and the costs of combating the effects of the corrosive and sometimes violent tropical climate. Indeed, the \$5 million in damage PRT's network recently sustained from Hurricane Jeanne is a case in point.³ Minimum maintenance on the system must be done regardless of the availability of universal service funds. However, additional expenditures (around \$26 million) in

³ Unfortunately, none of this is recoverable through insurance due to PRT's \$10 million deductible.

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the area of maintenance of outside plant are needed. The restoration of high cost funding would enable PRT to provide a more expanded and effective maintenance program that would better protect service reliability and prolong the life of the system.

Quality of Service. Puerto Ricans deserve the same quality of service enjoyed by other Americans. The recent termination of high cost universal service funding to Puerto Rico makes maintenance of service quality – not to mention improvements in quality – an uncertain enterprise. The restoration of high cost funding would enable PRT to take steps necessary to ensure that service quality is not only maintained, but improves. If funding commensurate with past levels were restored, PRT envisions investing \$20 million in enhanced service quality initiatives. Among other things, PRT would provide its technicians with better tools and access to improved support systems that will help them in identifying problems. This should speed service provisioning and reduce repair time.

Maintenance of Affordable Rates. Restoration of high cost universal service funding is also essential to maintain telephone rates that the people of Puerto Rico can afford. As noted above, the average annual salary in Puerto Rico is below \$10,000, far lower than any mainland state. As a result, subscribers in Puerto Rico are extremely price elastic – additional costs cannot simply be passed through to subscribers without further threatening Puerto Rico's already low penetration rate. Complicating this further is an ongoing rate rebalancing effort that is underway in Puerto Rico. Within the last year, PRT (with the cooperation and encouragement of the Board of Telecommunications Regulation of Puerto Rico) has reduced the number of local calling zones on the island from 68 to 10 and embarked on a phased-in rebalancing of rates.⁴ Low-income support does not completely address this problem because low-income support is a straight pass-through to the customer and does nothing to help the company maintain and operate the network. This is why high cost loop and low-income support have both been available to qualifying states for many years.

Education and Attraction of New Subscribers. As noted above, the existence of high cost loop support has been instrumental in making great strides in customer penetration rates over the years. In addition to assisting with building new plant and

⁴ Under the old plan, although many rural communities had local rates of \$7 to \$12, consumer phone bills were equal to or greater than those in urban areas with larger calling scopes because of the toll charges incurred by rural consumers.

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keeping rates affordable, a restoration of high cost universal service funding could also enable PRT to fund a program to educate consumers in Puerto Rico about telephone service. As the penetration rates suggest, some residents of Puerto Rico have never had telephone service and do not fully appreciate what it is or why they might benefit from it. If funding were restored, PRT would anticipate launching a house-to-house effort⁵ in some of the areas passed by telephone plant but with low penetration levels to educate residents about telephone service.

In sum, the restoration of high cost universal service funding to Puerto Rico, such as through an insular mechanism, is crucial not only to maintaining existing service levels in Puerto Rico but to ensuring all Puerto Ricans have access to basic telephone service comparable to their fellow Americans on the mainland. Given the extensive service challenges PRT faces and the extremely low telephone penetration rate on the island, Puerto Rico is precisely the type of area that should be receiving high cost funding, not one that should be zeroed out. As detailed above, PRT anticipates putting any restored funding to good use not only to maintain, but to improve and expand telephone service in Puerto Rico.

Please let me know if you have any further questions or require additional information.

Sincerely,

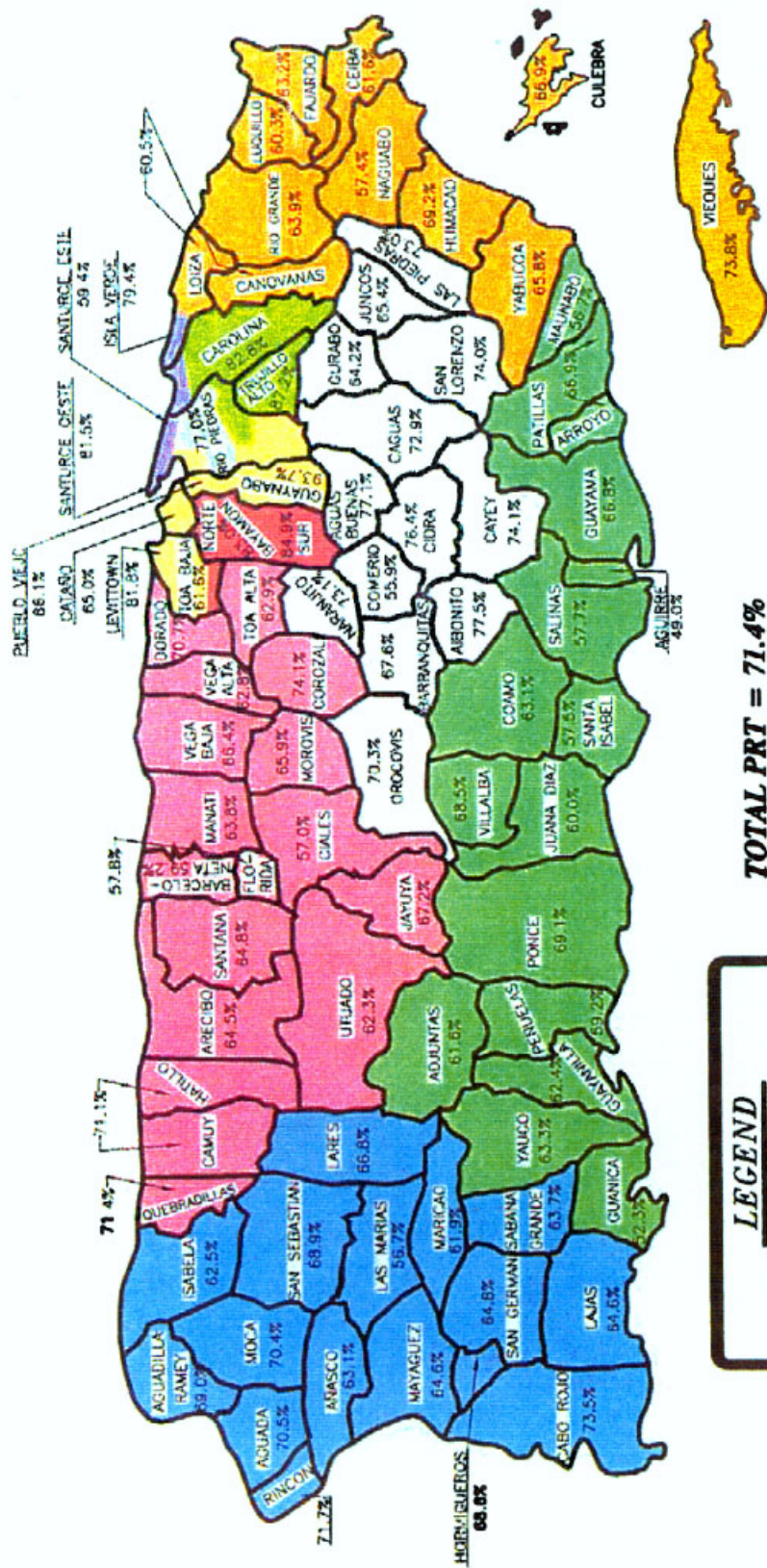
Nancy J. Victory

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Counsel for Puerto Rico Telephone Corp.

cc: Cathy Carpino
Narda Jones
Richard Lerner
Robert Tanner

⁵ In Puerto Rico, outreach to consumers by businesses is typically still done house-to-house.

PERCENTAGE OF HOUSEHOLDS WITH A PRT'S TELEPHONE LINE, DECEMBER 2002



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